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No.

IN THE

Supreme Court of the United States

October Term, 1986

T. J. Melton, III and Associates, Inc.,
and T. June Melton, III,

Petitioners

v.

Federal Deposit Insurance Corporation,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTIONS PRESENTED

I. Whether the statutory language of 12 U.S.C. §1823(e) which bars oral agreements between an Obligor and a failed bank from being asserted as a defense against a suit on a promissory note by the Federal Deposit Insurance Corporation in its corporate capacity encompasses situations where the maker of the note asserts economic duress.

II. Whether the statutory language of 12 U.S.C. §1823(e) which bars oral agreements between an Obligor and a failed bank from being asserted as a defense against a suit on a promissory note by the Federal Deposit Insurance Corporation in its corporate capacity encompasses situations where the maker of the note asserts economic duress and the Federal Deposit Insurance Corporation in its corporate capacity has notice of the assertion.

LIST OF PARTIES

The parties to the proceedings below were:

Petitioners here, Plaintiff-Third Party Defendant-Appellant, T. J. Melton, III and Associates, Inc.

Petitioners here, Third-Party Defendants-Appellants, T. J. Melton, III and Associates, Inc., and T. June Melton, III.

Respondents here, Defendant-Counterclaimant and Third-Party Plaintiff-Appellees, Federal Deposit Insurance Corporation, as successor to the First National Bank of Midland.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

CASES

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OCTOBER TERM, 1986

No.

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v.

FEDERAL DEPOSIT INSURANCE CORPORATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Petitioners, T. J. Melton, III and Associates, Inc. ("Melton, Inc."), and T. June Melton, III ("Melton"), respectfully pray that a Writ of Certiorari be issued to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this proceeding on December 29, 1986.

OPINIONS BELOW

The opinion of the Court of Appeals was unpublished. A copy of the opinion is attached hereto as Appendix A. The opinion of the United States District Court for the Western District of Texas granting a Judgment Notwithstanding the Verdict in Respondent's favor was unpublished. The opinion is attached hereto as Appendix C. The Judgment Notwithstanding the Verdict is attached hereto as Appendix B.

JURISDICTIONAL STATEMENT

The judgment of the Court of Appeals for the Fifth Circuit was entered on December 29, 1986. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1254(1).

STATUTE INVOLVED

This case involves the interpretation of §2[13](3) of the Federal Deposit Insurance Act of 1950, as amended, codified as 12 U.S.C. §1823(e) as follows:

> No agreement which tends to diminish or defeat the right, title or interest of the corporation in any asset acquired by it under this section, either as security for a loan or by purchase, shall be valid against the corporation unless such agreement (1) shall be in writing, (2) shall have been executed by the bank and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the bank, (3) shall have been approved by the Board of Directors of the bank or its loan committee, which approval shall be reflected in the minutes of said Board or committee, and (4) shall have been, continuously, from the time of its execution, an official record of the bank.

STATEMENT OF THE CASE

On February 29, 1980, Melton, Inc. entered into a loan agreement with the First National Bank of Midland ("FNBM") and, pursuant to the provisions of the loan agreement, Melton, Inc. executed a $2,967,000.00 promissory note and a $400,000.00 promissory note. Other promissory notes were subsequently executed pursuant to the provisions of the loan agreement (all such promissory notes are sometimes referred to herein as "the Notes"). Payment of the promissory notes was secured by certain real estate owned by Melton, Inc. and was guaranteed by Melton and certain other guarantors who were parties to the proceedings in the courts below. The

purposes of the loan agreement and notes were to finance the construction of duplexes and a water theme amusement park in Midland, Texas. The Notes could not be paid in accordance with their terms. After failed attempts by Melton, Inc. to renegotiate the terms of the Notes, the Notes went into default. In April, 1982, FNBM demanded payment in full and posted the real property which secured the indebtedness for foreclosure sale on the first Tuesday in June 1982.

On May 28, 1982, Melton, Inc. filed a petition in state court in Midland, Texas against FNBM alleging, among other allegations, that the loan agreement and promissory notes were executed as a result of economic duress imposed by FNBM. Additionally, Melton, Inc. sought a Temporary Restraining Order restraining the foreclosure and a declaration that the promissory notes executed were void. After the state court denied Melton, Inc.'s Application for a Temporary Restraining Order, Melton, Inc. filed for protection under Chapter 11 of the U.S. Bankruptcy Code. In October 1983, approximately seventeen (17) months after Melton, Inc. filed its lawsuit against FNBM, the office of the Comptroller of the Currency declared FNBM insolvent and appointed the Federal Deposit Insurance Corporation as receiver ("FDIC-R"). As is typical in a purchase and assumption transaction, the FDIC-R sold certain assets of FNBM, including the Melton, Inc. notes and guarantees, to the Federal Deposit Insurance Corporation acting in its corporate capacity ("FDIC-C") by Contract of Sale dated October 14, 1983. Subsequently, the FDIC-R substituted for FNBM and this case was removed to the United States District Court for the Western District of Texas. Removal to the District Court was proper and based on the District Court's jurisdiction pursuant to 12 U.S.C. §1819. Subsequently, after substitution of the parties, the FDIC-C brought a Counterclaim against Melton, Inc., Melton and the other guarantors seeking to enforce payment of the Notes.

As a defense against the Counterclaim, Petitioners alleged that the February 29, 1980 loan agreement and promissory notes were entered into only as a result of economic duress imposed by FNBM. Petitioners alleged that in November 1979

FNBM verbally agreed to lend Melton, Inc. $1.5 Million Dollars on favorable repayment terms. The proceeds of the loan were to be used by Melton, Inc. to construct a water theme amusement park. Pursuant to the verbal agreement FNBM immediately advanced Melton, Inc. $100,000 and represented that a written loan agreement would be prepared. In reliance upon such agreement and verbal representations, statements and inducements made by FNBM, Melton, Inc. immediately commenced construction of the water theme amusement park and, between November 1979 and January 1980, incurred indebtedness to FNBM of $300,000.00 and indebtedness to general creditors in excess of $150,000. Petitioners alleged that after Melton, Inc. became obligated on the indebtedness as a result of the representations of FNBM, FNBM wrongfully refused to honor its obligations and commitments and, instead, insisted on a loan agreement for $3,360,000 which contained very unfavorable repayment terms. Melton resisted the changed loan agreement but was told by FNBM's President that Melton, Inc. could either "take it or leave it". The economic circumstances in which Melton, Inc. then found itself left no choice but to agree to the loan. Accordingly, under economic duress, Melton, Inc. entered into the loan agreement on February 29, 1980.

On March 18, 1985, a trial commenced before six (6) jurors. On March 22, 1985, the jury returned its verdict in response to Special Interrogatories and found, among other things, that Melton, Inc. was under economic duress imposed by FNBM when it executed the February 29, 1980 loan agreement. Upon Motion by the FDIC, the District Court issued a Memorandum Opinion and Order and entered its Judgment Notwithstanding the Verdict that the FDIC-C recover $1,600,755.46 from Petitioners. The District Court determined that the finding of economic duress was not supported by the evidence.

After oral arguments, the Fifth Circuit Court of Appeals affirmed the District Court's Judgment Notwithstanding the Verdict, in part, on the basis of 12 U.S.C. §1823(e). Although the issue was clearly raised, the Fifth Circuit did not address the question of whether the jury's finding of economic duress

was supported by the evidence, but chose instead to construe the jury's finding of economic duress as merely an "attempt [by Petitioners] to defend because of oral agreements and representations, which they may not assert as defenses because 12 U.S.C. §1823(e) prevents it."

Because of the importance of clear precedent and the current split in authority between the circuits, the Petitioners have appealed.

REASONS FOR GRANTING THE WRIT

I. THE STATUTORY LANGUAGE OF 12 U.S.C. §1823(e) WHICH BARS ORAL AGREEMENTS BETWEEN AN OBLIGOR AND A FAILED BANK FROM BEING ASSERTED AS A DEFENSE AGAINST A SUIT ON A PROMISSORY NOTE BY THE FEDERAL DEPOSIT INSURANCE CORPORATION IN ITS CORPORATE CAPACITY DOES NOT ENCOMPASS SITUATIONS WHERE THE MAKER OF THE NOTE ASSERTS ECONOMIC DURESS.

On January 12, 1987, this Court granted a Petition for Writ of Certiorari in *Langley v. FDIC*, 792 F.2d 541 (5th Cir. 1986), *cert. granted*, ____ U.S. ____ (1987) (No. 86-489). The legal issue herein presented is virtually identical to the sole issue presented in *Langley* and contains the same underlying policy consideration as are raised in *Langley*. Accordingly, Petitioners urge the Court to grant their Petition for Writ of Certiorari and consider the instant case as a companion case to *Langley*. As in the *Langley* case, the Fifth Circuit's affirmation of the District Court's Judgment Notwithstanding the Verdict in this case creates a split in authority between the circuit courts regarding the interpretation of 12 U.S.C. §1823(e). *Compare Gunter v. Hutcheson*, 674 F.2d 862 (11th Cir.), *cert. denied*, 459 U.S. 826 (1982) and *FDIC v. Hatmaker*, 756 F.2d 34 (6th Cir. 1985) *with FDIC v. Lattimore Land Corp.*, 656 F.2d 139 (5th Cir. 1981).

On its face, §1823(e) protects the FDIC in its corporate capacity from "agreements" which do not satisfy the section's requirements.

A variety of state law defenses which have been construed as "agreements" have been asserted as affirmative defenses to the FDIC-C's attempts to collect on notes it has acquired through purchase and assumption transactions. One such affirmative defense is fraud in the inducement. The issue of whether §12 U.S.C. 1823(e) prevents fraud in the inducement from being asserted against the FDIC-C has been, as discussed more fully below, considered by several circuit courts. This Court has granted a Petition for Writ of Certiorari in the *Langley* case to consider such issue.

A consideration of the issue presented in *Langley* is necessary to analyze the issue presented in this Petition. The affirmative defense of economic duress is closely akin to that of fraud in the inducement. Both defenses are challenges to the validity of the notes in issue from their inception. Only one reported case has been found that addresses whether the defense of economic duress can be asserted against the FDIC-C and it characterizes the defense of economic duress as being akin to the defense of fraud in the inducement. *FDIC v. Balistreri*, 470 F. Supp. 752 (E. D. Wis. 1979).

In *Balistreri*, the defendant borrower was president of the American Menomonee Falls Bank ("American Menomonee") which was a member bank of the American Bankshares Corporation holding company. The defendant, through his position at American Menomonee, learned that a sister bank in the American Bankshares holding company, American City Bank & Trust ("American City Bank") was encountering financial difficulty and needed to raise more capital. Through a series of transactions, the defendant purchased American City Bank Stock and financed his purchase by executing notes payable to American City Bank (all of which notes were later consolidated into the single note in issue). Subsequent to the execution of the note in issue, American City Bank failed.

The FDIC-R was appointed the receiver of American City Bank. The note in issue was later sold to the FDIC-C which sued defendant to collect the note. The defendant asserted three affirmative defenses to the FDIC-C's suit including the defense of economic duress. The defendant asserted

economic duress, alleging that he executed the Notes because he feared his job would be in jeopardy if American City Bank failed.

The FDIC-C moved for summary judgment. The district court considered all the affirmative defenses including economic duress in light of §1823(e). The Court classified the defense of economic duress as akin to the defense of fraud in the inducement. The Court stated:

> The defenses raised by defendant are best characterized as involving fraud in the inducement because the defendant is attacking the agreements underlying the note contract rather than the validity of the contract inherent in the making of the note. 470 F. Supp at 754.

This analysis by the District Court is applicable in the instant case. The defense asserted by the Petitioner in *Langley* involves fraud in the inducement and the issue in the instant case involves economic duress. Accordingly, *Balistreri* is authority for the proposition that *Langley* and the instant case present virtually the identical issue and hence should be considered by this Court as companion cases.

In *Balistreri*, the District Court did not reach the issue of whether §1823(e) barred the defendant's affirmative defense of economic duress. The Court found that, as a matter of Wisconsin law, legally sufficient duress did not exist under the particular facts of the case. 470 F. Supp at 758.

As to the issue of whether fraud in the inducement could be asserted against the FDIC-C in light of §1823(e), the court held that §1823(e) barred the defense. This determination, however, is not controlling in the instant case as the *Balistreri* case was decided prior to the distinction, as more fully discussed below, between the various types of fraud in the inducement and their viability as defenses against the FDIC-C's statutory shield of §1823(e) which has been established in *Gunter* and *Hatmaker*.

The Eleventh and Sixth Circuits in *Gunter* and *Hatmaker* have created a distinction between two types of fraud in the

inducement in determining whether or not the section bars the affirmative defense of fraud in the inducement. An oral promise made by a bank to perform some act in connection with the execution of a note without the intention to perform the act is an "agreement" according to those decisions. The Eleventh and Sixth Circuits have found that §1823(e) does bar any affirmative defense of fraud in the inducement if the fraud relates to a promise made by the bank to perform some act in connection with the execution of the note. The other type of fraud in the inducement which is not barred by §1823(e) according to those decisions is a knowing misrepresentation by the bank without promising to do any act in order to induce a party to enter into an agreement to execute a promissory note. With this latter type of misrepresentation there is no "agreement" but rather a representation and, accordingly, such affirmative defense is not barred by §1823(e).

In *Gunter*, suit was brought by the makers of a promissory note against the FDIC, the failed bank and some of its officers. The FDIC had acquired the note from another bank by way of a purchase and assumption agreement. Rescision was sought against the FDIC based on fraud and securities violations. In particular, a bank officer on behalf of the failed bank, made the representation to the Gunters that the bank was in "sound financial condition." An appeal was taken from the granting of a summary judgment motion in favor of the FDIC on other grounds. The FDIC alleged that it was protected by §1823(e) or under Federal common law. The Eleventh Circuit Court of Appeals held that Gunter's affirmative defense of fraud regarding the misrepresentations made by the failed bank was not barred by §1823(e). 672 F.2d at 867.

In *Gunter*, after analyzing several Fifth Circuit opinions, the Court succinctly articulated its reasoning in distinguishing the two types of fraud as follows:

> The common thread running through [the Fifth Circuit decisions] has been the assertion by the obligor that an oral agreement with the bank

> controlled the rights of the parties. The cases, therefore, came squarely within the "no agreement . . . shall be valid" language of §1823(e). The claim asserted by the Gunters, in contrast, is quite different. The essence of their argument is that no agreement existed because of the fraud of Chattanooga Hamilton's officers. While certain of the alleged misrepresentations could be construed as "agreements" to perform certain acts in the future, such as deferring interest on the Gunter's notes, others clearly are not agreements of any sort. * * * Far from claiming that an oral agreement is "valid" and controls the rights of the parties, the Gunters assert that the entire transaction was invalid from the beginning. 672 F.2d at 867.

Petitioners have alleged that the February 29, 1980 loan agreement and the notes executed pursuant thereto were entered into due to the economic duress imposed by FNBM, and the jury so found. The economic duress resulted, in part, from the misrepresentations by FNBM concerning a commitment in November 1979 to loan Melton, Inc. $1.5 Million Dollars, with favorable repayment terms. After advancing approximately $300,000.00, FNBM wrongfully changed the agreed terms and insisted upon the onerous terms contained in the February 29, 1980 loan agreement. In reliance on FNBM's November 1979 commitment, Melton, Inc. had incurred in excess of $450,000.00 in liabilities. Not surprisingly, Melton vigorously protested the proposed terms of the February 29, 1980 agreement. The response by the President of FNBM to Melton's protests was that Melton, Inc. had only one option with respect to the February 29, 1980 agreement, Melton could "take it or leave it." Because of Melton, Inc.'s precarious financial condition resulting from its reliance on FNBM's previous commitments, Melton, Inc. had no real choice but to enter into the February 29, 1980 agreement and to execute the Notes pursuant to their terms. Petitioners do not seek to enforce the November 1979 agreement but rather assert that it is a portion of the factual

circumstances creating the economic duress imposed by FNBM. As in the *Gunter* case, Petitioners assert that the February 29, 1980 loan agreement and the Notes were invalid from the beginning by reason of the economic duress. Accordingly, Petitioners are not trying to enforce or assert any oral agreement that "controls the rights of the parties". Hence, Melton, Inc.'s defense, according to the *Gunter* rationale, can be asserted against the FDIC-C.

In *FDIC v. Hatmaker*, 756 F.2d 34 (6th Cir. 1985), the Sixth Circuit endorsed the reasoning of the *Gunter* case, and set forth the analysis which distinguishes between fraud in the inducement which is barred by §1823(e) and fraud in the inducement not barred by the section. The court stated:

> One type of fraud in the inducement is an oral promise by the bank to perform a duty in connection with the execution of a note that the bank does not intend to perform. An example of such fraud in the inducement is a promise by the bank to make future loans to the borrower which the bank does not plan to perform. *See, FDIC v. Lattimore Land Corp.*, 656 F.2d 139 (5th Cir. 1981). Another type of fraud in the inducement is a misrepresentation made by the bank, not involving any promise, to induce a party to execute a promissory note. A good example of such fraud in the inducement is a misrepresentation by the bank that it is in sound financial condition in order to induce a party to borrow money to purchase stock. *Gunter*, 674 F.2d at 867. In the second type of fraud in the inducement, no side agreement exists between the parties, and §1823(e) cannot be applicable. In the first case, however, a side agreement is present to which §1823 can be applied. Although that side agreement may have been fraudulently induced, it is still a separate agreement into which the parties voluntarily entered. 756 F.2d at 36-37.

The United States District Court for the Western District of Oklahoma in *In Re Longhorn Securities Litigation*, 573 F.

Supp. 278 (W.D. Ok. 1983), also noted the above distinction in holding that *D'Oench Duhme & Company v. FDIC*, 315 U.S. 447 (1942), did not apply to the facts of that case (which concerned a representation that letters of credit would not be called) and stated that the court's holding in *D'Oench Duhme* is a narrow one. Although the case considered the FDIC in its capacity as a receiver rather than the FDIC in its corporate capacity, the reasoning stated in the opinion is applicable to the instant case. The court found that because the case did not concern an "agreement", but rather, concerned the lack of an agreement at all, *D'Oench Duhme* did not apply.

Although *Gunter*, *Hatmaker* and *Longhorn*, involved cases in which the affirmative defense of fraud in the inducement was raised to bar a suit on the note in question, the holdings are equally applicable to the affirmative defense of economic duress in the case at bar in that both defenses challenge the validity of the notes from their inception. The elements of the affirmative defense of economic duress have been expressed in several ways. One court has held that economic duress involves a threat to do an act which the threatening party has no right to do coupled with fraud or deception; which threat is so imminent that it destroys the freewill of the threatened party. *Laughlin v. FDIC*, 657 S.W.2d 477 (Tex. App. - Tyler 1983, no writ).

In *State Nat'l Bank v. Farah Manufacturing Co.*, 678 S.W.2d 661 (Tex. App. - El Paso 1984, writ dism'd by agreement), the court enumerated the elements of duress as follows:

> *Del v. Simon*, 267 S.W. 467, 470 (Tex. Comm'n App. 1924, judgmt adopted) is the leading case as to the elements of and the limitations upon the cause of action for duress. It was held there:
>
> > There can be no duress unless [1] there is a threat to do some act which the party threatening has no legal right to do. [2] Such threat must be of such character as to destroy the free agency of the party to

> whom it is directed. It must overcome his will and cause him to do that which he would not otherwise do, and which he was not legally bound to do. [3] The restraint caused by such threat must be imminent. [4] It must be such that the person to whom it is directed has no present means of protection.

Further elements stated are in regard to the availability of the courts to the threatening party in the enforcement of his legal right:

> [5] Where demand made is wrongful or unlawful, and it is necessary for the party making such demand to resort to the courts to enforce same, there is no duress, for the one upon whom demand is made has adequate means of protection, and there is not imminent restraint. . . . [6] But where the party making such demand has, or is supposed to have, the power to injure the business or property interest of the one upon whom such demand is made, without resort to the courts to enforce the demands, and threatens to do an act which would cause such injury, and which he has no right to do, and thereby induces a compliance with his demand, [7] against the will of such party through fear of injury to his business or property interest, such threats amount to duress, [8] if it appears that the party making such demand and threat ought not in good conscience to retain the benefit received by reason thereof.

* * *

Economic duress (business coercion) may be evidenced by forcing a victim to choose between

> distasteful and costly situations, i.e., bow to duress or face bankruptcy, loss of credit rating, or loss of profits from a venture. 13 Williston on Contracts sec. 1617 (3d Ed. 1970), citing *Housing Authority of the City of Dallas v. Hubbell*, 325 S.W.2d 880 (Tex. Civ. App. - Dallas 1959, writ ref'd n.r.e.). 678 S.W.2d at 684-86.

Finally, one other definition of duress was provided in *Tower Contracting Co., Inc. v. Burden Bros. Inc.*, 482 S.W.2d 330 (Tex. Civ. App. - Dallas 1972, writ ref'd n.r.e.). In this case the Court stated:

> [O]ur courts of Texas have consistently followed the rule, as a matter of law, that (1) there can be no duress unless there is threat to do some act which the party threatening has no legal right to do; (2) there must be some illegal exaction or some fraud or deception; (3) the restraint must be imminent and such as to destroy free agency without present means of protection. 482 S.W.2d at 335.

Petitioners have alleged that they executed the February 29, 1980 loan agreement, notes and guarantees by reason of the economic duress imposed upon Melton, Inc. by FNBM. Such economic duress resulted from Melton, Inc.'s reliance upon the agreements and representations previously made by FMBM coupled with the "take it or leave it" threat by FNBM in breach of the agreements and in breach of its duty of good faith and fair dealing. *Restatement (Second) of Contracts* §176 (1981). *Farah Manufacturing*, 678 S.W.2d at 685.

As in *Gunter*, Melton, Inc. does not seek enforcement of the November 1979 representations made by FMBM but rather contends that the February 29, 1980 loan agreement and notes executed pursuant thereto were invalid from their inception due to economic duress. The November 1979 representations and agreements are only significant in conjunction with the proof of economic duress because the agreements make the later conduct of FNBM's President a wrongful threat within the definition of economic duress. The

allegations of economic duress contained in Melton, Inc.'s original complaint and contained in its answer to the FDIC-C's counterclaim, which were amply supported by the evidence, negates the validity of the February 29, 1980 loan agreement and the Notes.

II. THE STATUTORY LANGUAGE OF 12 U.S.C. §1823(e) WHICH BARS ORAL AGREEMENTS BETWEEN AN OBLIGOR AND A FAILED BANK FROM BEING ASSERTED AS A DEFENSE AGAINST A SUIT ON A PROMISSORY NOTE BY THE FEDERAL DEPOSIT INSURANCE CORPORATION IN ITS CORPORATE CAPACITY DOES NOT ENCOMPASS SITUATIONS WHERE THE MAKER OF THE NOTE ASSERTS ECONOMIC DURESS AND THE FEDERAL DEPOSIT INSURANCE CORPORATION IN ITS CORPORATE CAPACITY HAS NOTICE OF THE ASSERTION.

Even if the affirmative defense of economic duress is not assertable against the FDIC as a result of 12 U.S.C. 1823(e) where the FDIC does not have notice of the defense, a different rule should apply when the FDIC has notice of the defense. The Eleventh Circuit Court of Appeals in *Gunter* stated:

> [W]e hold that as a matter of federal common law, the FDIC has a complete defense to state and common law fraud claims on a note acquired by the FDIC in the execution of a purchase and assumption transaction, for value, in good faith, *and without actual knowledge of the fraud at the time the FDIC entered into the purchase and assumption agreement.* 674 F.2d at 873 (emphasis added).

The Eleventh Circuit's holding indicates that the result should be different if the FDIC has actual notice of the state law claims, whether it be fraud or, in the instant case, economic duress, at the time the FDIC enters into the purchase and assumption agreement. Indeed, the Eleventh Circuit's rationale in *Gunter* indicates why it limits its holding to cases where the FDIC has no actual notice. It states:

[T]he FDIC may enter into a purchase and assumption transaction only 'whenever in the judgment of the Board of Directors such an action will reduce the risk or avert a threatened loss to the corporation . . . .' To make this statutory judgment, the FDIC must have some method to evaluate its potential liability in a purchase and assumption versus its potential liability from a liquidation. Because of the time constraints involved, the only method of evaluating potential loss open to the FDIC is relying on the books and records of the failed bank to estimate what assets would be returned by a purchasing bank and to estimate which of those assets ultimately would be collectible. The corporation can then compare its estimated loss from a purchase and assumption against its estimated loss from a liquidation and make the statutory judgment required under §1823(e).

If the FDIC's right to collect on the returned assets, however, were subject to fraud claims of which the FDIC *lacked knowledge*, estimating its potential loss from a purchase and assumption would be impossible. The corporation could not predict from the bank records which assets would likely be collectible and which would be subject to unknown claims of fraud. Consequently, the FDIC cannot make the judgment necessary under §1823(e) and the purchase and assumption method of handling bank failures would be effectively foreclosed. 674 F.2d at 870 (footnote omitted, emphasis added).

As the above quote indicates, the Eleventh Circuit was concerned about the FDIC's ability to evaluate its potential losses when it "lacked knowledge" of state law claims. However, this compelling protective rationale is not nearly so compelling when the FDIC has notice of the state law claims asserted. This is particularly true where, as in the instant case, the borrower has already asserted those claims in a

lawsuit against the bank prior to the time the FDIC in either of its capacities enters into the fray.

It must be noted, however, that other circuits have uniformly held that "the FDIC's knowledge 'whether actual or constructive' of the alleged defense is . . . immaterial under §1823(e)." *Langley v. FDIC*, 792 F.2d 541, 545 (5th Cir. 1986), *cert. granted*, ____ U.S. ____ (1987) (No. 86-489) (citing *FDIC v. de Jesus Velez*, 678 F.2d 371, 375 (1st Cir. 1982) and *FDIC v. Investors Associates X., Ltd.*, 775 F.2d 152, 155-56 (6th Cir. 1985)). A variety of rationales have been asserted for this position.

In *de Jesus Velez*, the court determined that actual knowledge was not relevant as §1823(e) was explicit with respect to the requirements (including how the agreement must be recorded in the bank's records) to constitute a valid collateral agreement. In *Investors Associates*, the rationale for stating that notice is irrelevant under §1823(e) was based on the proposition that public policy prevents a wrongdoer (in that case an overly trusting borrower who was unwillingly caught up in a fraudulent scheme) from benefiting from a fraudulent scheme to hide side agreements from the bank examiners. *But see FDIC v. Berr*, 643 F. Supp. 357 (D. Kan. 1986) (rationale stated in *Investors Associates* need not be basis for concluding that actual knowledge of FDIC is irrelevant in application of §1823(e)).

Other courts have gone further and stated that knowledge of a defense to collection of a note which is known by the FDIC's open-bank division is not imputed to the FDIC's closed-bank division as such an attribution of knowledge would "undercut [the] FDIC's ability to value assets quickly and precisely. . . ." *FDIC v. Merchant's National Bank*, 725 F.2d 634, 640 (11th Cir.), *cert. denied*, 469 U.S. 870 (1985). *Also see Gilman v. FDIC*, 660 F.2d 688, 694-95 (6th Cir. 1981); *FDIC v. Leach*, 772 F.2d 1262, 1268 (6th Cir. 1985) (concurring opinion); *Southern Industrial Realty, Inc. v. Noe*, 628 F. Supp. 92, 94 (D.P.R. 1986); *FDIC v. MM & S Partners*, 626 F. Supp. 681, 684 (N.D. Ill. 1985).

One court has considered the issue of whether a borrower's state law defenses to collection of a note are barred by

§1823(e) when the borrower has already filed the lawsuit when the FDIC takes the note in issue and the FDIC has knowledge of the suit. *FDIC v. First Mortgage Investors*, 485 F. Supp. 445, 451 (E.D. Wis. 1980). For a variety of public policy reasons, the court in *First Mortgage Investors* held that, nothwithstanding the borrower's pending lawsuit and the FDIC's knowledge of the claims made in the lawsuit, the FDIC is not barred from asserting its §1823(e) defense as to those claims. The Court indicates that the motive of Congress in establishing the FDIC was to promote soundness in the banking system and to assist the government in discharging its financial transactions. As part of its function, the FDIC is to purchase certain assets of closed banks to facilitate the sale of closed institutions to other banks. It then protects itself and its insurance fund by attempting to collect on the notes it purchases. In order to achieve this, it is important that the FDIC be permitted to assess the various assets of the failed bank "in an orderly and dependable fashion." 485 F. Supp. at 451. The bank is not required to go beyond the bank records in performing its functions. The court considered and then rejected the possibility that a different rule would be workable:

> If, however, the FDIC must examine records outside the bank to evaluate an asset, the burden borne by it is much greater. Here, for example, the FDIC would have to have had examined the defenses raised by [the borrower] in its answer to [the bank's] complaint plus any evidence presented by [the borrower] in opposition to the pending motion for summary judgment. Furthermore, the FDIC would have the burden of assessing the defenses presented. In essence, it could not then rely upon the records of the closed bank.

Notwithstanding the foregoing authorities, no valid rationale exists for barring an obligor's right to pursue a defense of which the FDIC has notice. When the FDIC has actual notice of the defenses asserted it may assess its potential success in collecting the note in issue. A distinction

should be made between a rule which bars affirmative relief against the FDIC-R and a rule which bars an affirmative defense against the FDIC-C's attempt to collect on a note. A rationale exists for barring claims against the FDIC-R, even if the FDIC-R has notice of the claims, inasmuch as the FDIC-R needs to quickly assess its potential liabilities. Knowledge of the claim does not enable the FDIC-R to quickly quantify the amount of the liability. Contrarily, the same rationale does not apply to bar defenses to the collection of a note by the FDIC-C. If the FDIC-C has actual notice that a defense has been raised to the collection of a note, it becomes aware that the note may be uncollectible. Such risk is inherent in all notes purchased by the FDIC-C, if for no other reason than the simple financial inability of the obligor to pay the note. Therefore, in the instant case, Petitioners should be permitted to assert the defense of economic duress as the FDIC had actual notice of the defense.

CONCLUSION

The Fifth Circuit's opinion in this case as well as in the case of *Langley v. FDIC*, 792 F.2d 541 (1986), *cert. granted* _____ U.S. _____ (1987), (No. 86-489) is in direct conflict with the Eleventh and Sixth Circuit cases of *Gunter* and *Hatmaker*. Petitioners respectfully submit that certiorari should be granted in this case to resolve the conflict in the circuit courts regarding the scope of 1823(e) in order to resolve this conflict and that should this Petition for Writ of Certiorari be granted, that it be heard and decided concurrently with the *Langley* case.

For these reasons, Petitioners respectfully request this Petition for Writ of Certiorari be granted, and that upon final hearing in this Court, this Court determine as a matter of law that the jury's finding of economic duress is supported by the evidence and that §1823(e) does not bar such defenses to the claims by the FDIC; or, in the alternative that this Court determine that §1823(e) does not bar the affirmative defense of economic duress and remand this cause to the Fifth Circuit Court of Appeals for a ruling on the District Court's Judgment

Notwithstanding the Verdict which set aside the jury's findings of economic duress.

Respectfully submitted,

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Dated: March 1987

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 85-1331
& 86-1285

T. J. MELTON, III and
ASSOCIATES, INC.,

Plaintiff-Appellant,
Cross-Appellee,

versus

FEDERAL DEPOSIT INSURANCE
CORP., *etc.*, *et al.*,

Defendants-Appellees,
Cross Appellants,

FEDERAL DEPOSIT INSURANCE
CORP., *etc.*, *et al.*,

Third Party Plaintiff-
Appellee, Cross-Appellant,

versus

T. J. MELTON, III and
ASSOCIATES, INC., *et al.*,

Third Part Defendants-
Appellants, Cross-Appellees.

Appeal from the United States District Court for
the Western District of Texas

(December 29, 1986)

Before GOLDBERG, REAVLEY and GARWOOD, Circuit Judges.

PER CURIAM:[1]

The judgment of the district court is affirmed in all respects except for the denial of attorney fees to the FDIC in its corporate capacity for the amounts due under the promissory notes. We remand for the court to set the fee award.

Our reasons for this decision are these:

1. On October 14, 1983 FDIC, in its corporate capacity, purchased from FDIC as receiver the promissory notes executed by the Melton corporation and guaranteed by the other appellants. The appellants attempt to defend because of oral agreements and representations, which they may not assert as defenses because 12 U.S.C. §1823(e) prevents it. They argue that secret or side agreements may be given effect where the FDIC has notice of them prior to its purchase of the written instruments. This court has rejected that contention in *FDIC v. Langley*, 792 F.2d 541 (5th Cir. 1986). The FDIC is not limited to the rights of a holder in due course. The statute ensures "that the FDIC may rely on the books and records of an insured institution by requiring that material agreements concerning a loan transaction be set forth in the bank's records." 792 F.2d at 544. Knowledge, actual or constructive, of the defense is immaterial if it does not meet the requirements of §1823(e). 792 F.2d at 545. For the same reason FDIC-C may enforce the guaranty agreements as written. See *FDIC v. Castle*, 781 F.2d 1101 (5th Cir. 1986).

2. We are not helped by the parties on the requirements and consequences of a valid claim against the FDIC as receiver of FNB. For present purposes we will assume that, following insolvency of FNB, the Melton corporation could proceed against the bank's receiver for either contract or tort

[1] Local Rule 47.5 provides: "The publication of opinions that have no precedential value and merely decide particular cases on the basis of well-settled principles of law imposes needless expense on the public and burdens on the legal profession." Pursuant to that Rule, the court has determined that this opinion should not be published.

claims. And we assume that a judgment in favor of Melton would entitle the corporation to share with other creditors in some measure. However, on this record no judgment of that nature can stand. We agree with and affirm the district court, ultimately because Melton failed to prove reasonably certain damages caused by any failed promise or wrong of FNB. Melton's position is that, after being denied the $1.5 million loan, he took the next best thing. When the venture failed two years later, he claims that the bank should take all of his loss. There are many difficulties with that claim. The bank did not upgrade and overstaff the Wild River Canyon. The bank did not turn Midland economy down. The principal reason Melton failed was that his property and duplexes did not sell. He seeks a judgment making the bank pay for all that, and the evidence will not warrant it.

3. We will assume that FNB agreed to the $1.5 million loan and promised to make it with the intent not to do so. We will even assume that Melton signed the February 1980 notes and agreement under some duress. But Melton did not undertake to prove those damages. He was not satisfied to avoid further business risk or to rescind his written contract. He chose to build and to keep borrowing. Without employing the doctrines of ratification or estoppel, certainly there is no proof of Melton's damages caused by culpability of the bank. He speaks of some $600,000 in round figures he spent in 1979 and early 1980, but there is no attempt to prove damages at that point. The evidence of damages consists of an expert accountant who simply added figures given to him. By doing so he obtained money totals supposed to reflect Melton's position if he had operated with the promised $1.5 million loan as contrasted with what actually happened to Melton. The difference is presented as damages caused by FNB.

On the one hand the accountant assumed that Wild River Canyon would have operated with the same results (attendance, revenue, expense, and profit) in the years of 1980 through 1985 that Melton predicted in 1979 by his pro forma statement. Experience disproved those projections, and the bank's loan terms are not blamed for that experience. The damages expert adjusted for the realized two year losses

(rather than the $400,000 profit) by simply assuming the sale of Westgate land to cover extra expenses and debt service. He then assumed that Melton would have lost no assets by default or foreclosure, and that he would have profitted beautifully by the sale of all the Westgate land by June of 1982 — with cash in hand to reap $431,000 in interest in the next two years. This assumption is unwarranted by the evidence, and it is inconsistent with all of the testimony of the witnesses about the experience at the park and in Midland in those two years. The assumptions about the park's operations and the land sales are unsupported by the evidence. Furthermore, whatever the bank did that created problems and losses for Melton, there is no evidence that the bank interfered with the park's operation or prevented land sales. If Melton could have met these assumptions with a $1.5 million loan, there is no reason to believe that he could not have done so under the bank's February loan. It may have cost more interest, and Melton may have been required to pay the park construction loan out of land sales (just as the expert assumed) rather than build duplexes. With all of the land sales his expert assumed to be possible by June 1982, Melton would have easily had the cash to pay for any draws on the FNB's loans before August 1981. Melton may have suffered damages because he did not get the $1.5 million loan, but he has made no attempt to prove what they were. Instead, he has tried to charge the bank for all of the losses of his questionable business ventures in an economy that turned down. The district court correctly ruled that the evidence and verdict could not support judgment for the Melton corporation.

4. Melton also attempted to prove continuing responsibility for the corporation's demise by claiming breaches by the bank of the February agreement. First, he says the bank insisted on permanent lending commitments prior to advancing the profit portion of the duplex price, even though that provision of the agreement had been waived. Second, he says the bank prevented a sale by refusing to release part of block 7 as required to do by the agreement. The jury read the agreement as Melton urged, but there was no fact question about it. And Melton's arguments to the court are frivolous. There is no

evidence that the bank surrendered its right to require the commitments, only that on some loans it advanced money without commitments. Melton gave up nothing and made no change of position. The bank was clearly entitled to do as it did. As for the block 7 sale, nothing in this agreement would require the bank to release its lien for substantially less than Melton claimed the land to be worth. The paragraph to which Melton points creates no right of release.

5. The district court denied FDIC its attorney's fees without comment. The parties stipulated that the promissory notes provided for the collection of reasonable attorney's fees, in one instance not to be less than ten percent of the amount due. The record shows that the judge followed the practice of deciding the fee awards without the jury. No party objected to that. No reason is shown why FDIC should not obtain judgment for those fees.

The judgment of the district court is affirmed except for the denial of attorney fees to the FDIC in its corporate capacity. The cause is remanded for the district court to determine the amount of those fees.

AFFIRMED IN PART; REVERSED IN PART AND REMANDED.

APPENDIX B

**IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
MIDLAND/ODESSA DIVISION**

<table>
<tr><td>T. J. MELTON, III and
ASSOCIATES, INC.,
Plaintiff

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, in its capacity as receiver of FIRST NATIONAL BANK OF MIDLAND and ALAN A. AARON, Substitute Trustee,
Defendants

and

FEDERAL DEPOSIT INSURANCE CORPORATION, in its Corporate Capacity,
Counterclaimant and Third-Party Plaintiff

v.

T. J. MELTON, III and ASSOCIATES, INC., T. JUNE MELTON, III, JOHN C. ALLMAN, JR., LYNN W. BRYANT, T. JUNE MELTON, M.D., and A. J. GALLERANO,
Third-Party Defendants</td><td>NO. MO-84-CA-22</td></tr>
</table>

JUDGMENT NOTWITHSTANDING THE VERDICT

In accordance with the Memorandum Opinion heretofore entered, the Court hereby issues it [sic] Judgment notwithstanding the verdict as follows:

IT IS ORDERED, ADJUDGED, and DECREED that the verdict of the jury be, and it is hereby, set aside and judgment is entered for FDIC-R that plaintiff take nothing as against FDIC-R.

IT IS FURTHER ORDERED, ADJUDGED and DECREED that FDIC-C do have and recover of and from MELTON, INC., MELTON, and LYNN BRYANT the sum of $1,600,755.46, plus accrued interest, for which sum said defendants shall be jointly and severally liable.

IT IS FURTHER ORDERED, ADJUDGED and DECREED that ALLMAN, ALLMAN, JR., DR. MELTON and GALLERANO are each responsible for $100,000 of the total amount due and owing the FDIC.

IT IS FURTHER ORDERED, ADJUDGED and DECREED that FDIC-C's interest in the pledged properties, evidenced by the applicable Deeds of Trust and Security Agreements are valid and are to remain in effect in favor of FDIC-C.

IT IS FURTHER ORDERED, ADJUDGED and DECREED that the FDIC's claim for attorneys' fees be, and it is hereby, DENIED.

IT IS FURTHER ORDERED, ADJUDGED and DECREED that costs are hereby assessed against MELTON, INC. and the guarantors, for which sum defendants shall be jointly and severally liable, and for which execution may issue if not timely paid.

All relief not expressly granted herein is in all things DENIED.

SIGNED and ENTERED this the 19th day of April, 1985.

/s/

LUCIUS D. BUNTON
United States District Judge

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
MIDLAND/ODESSA DIVISION

T. J. MELTON, III and ASSOCIATES, INC., *Plaintiff*	
v.	
FEDERAL DEPOSIT INSURANCE CORPORATION, in its capacity as receiver of FIRST NATIONAL BANK OF MIDLAND and ALAN A. AARON, Substitute Trustee, *Defendants*	
and	NO. MO-84-CA-22
FEDERAL DEPOSIT INSURANCE CORPORATION, in its Corporate Capacity, *Counterclaimant and Third-Party Plaintiff*	
v.	
T. J. MELTON, III and ASSOCIATES, INC., T. JUNE MELTON, III, JOHN C. ALLMAN, JR., LYNN W. BRYANT, T. JUNE MELTON, M.D., and A. J. GALLERANO, *Third-Party Defendants*	

MEMORANDUM OPINION AND ORDER

On the 18th day of March, 1985, this cause came on for trial before the Court and a jury. In answers to the special interrogatories, the jury returned a verdict in favor of plaintiff on all four causes of action, i.e., breach of verbal agreement, fraud, economic duress and breach of the written contract. Specifically, the jury found that FIRST NATIONAL BANK OF MIDLAND ("FNBM") entered into a verbal agreement with T. J. MELTON, III and ASSOCIATES, INC. ("MELTON, INC.") in November of 1979 to loan MELTON, INC. $1,500,000 for six years at 15%, that FNBM breached such verbal agreement, and that MELTON, INC. was injured in the amount of $3,091,500 by such breach. The jury found that FNBM fraudulently represented to MELTON, INC. in November, 1979 that it would lend $1,500,000 for six years at 15%, and that MELTON, INC. was damaged by such representation in an amount of $730,000. The jury found that MELTON, INC. was under economic duress at the time it entered into the February 29, 1980 loan agreement with FNBM, and that MELTON, INC. was damaged in the amount of $5,121,000. The jury also found that FNBM breached the February 29 loan agreement and that such breach resulted in damage to MELTON, INC. in the amount of $1,482,000.

With reference to the personal guaranty of T. J. MELTON III ("MELTON"), the jury found that FNBM fraudulently induced MELTON to sign the guaranty. The jury also found that the personal guaranties of JOHN C. ALLMAN ("ALLMAN") JOHN ALLMAN, JR., ("ALLMAN, JR.") A. J. GALLERANO ("GALLERANO") and DR. T. J. MELTON ("DR. MELTON") were limited to a note in the amount of $480,000. For the following reasons, the Court enters Judgment on behalf of FEDERAL DEPOSIT INSURANCE CORPORATION, in its capacity as receiver ("FDIC-R") and for FEDERAL DEPOSIT INSURANCE CORPORATION, in its corporate capacity ("FDIC-C").

The undisputed testimony at trial showed that in late October or early November, 1979, MELTON approached FNBM for the purpose of obtaining a $1,500,000 loan at 15% for six years for the construction of an amusement park in

the Midland/Odessa area. MELTON informed FNBM at that time that the amusement park, known as the WILD RIVER CANYON ("the Park") could be constructed for $1,500,000. MELTON had two meetings with FNBM officials and then had a meeting with Bill Gilluly, a commercial loan officer, in November, 1979.

The outcome of that November meeting was disputed at trial. It was the position of MELTON that FNBM agreed to make the loan on the terms as outlined by MELTON. FNBM claimed, through the testimony of Bill Gilluly, that no deal was made at that time. FNBM agreed to consider the deal, but more information was required and the parties began negotiations. MELTON also testified that he subsequently increased his request to $1,700,000. Testimony at trial also established that during the period between November, 1979 and February 29, 1980, MELTON was providing additional information as requested by FNBM. Further, Gilluly indicated that FNBM was not interested in loaning money on a venture as speculative as an amusement park and that was why the eventual loan covered the park property and the surrounding commercial property, which was to be for commercial and duplex development ("Westgate Acres").

It was stipulated by the parties that FNBM loaned MELTON, INC. $100,000 on three occasions: November 8, 1979, December 17, 1979 and January 21, 1980. MELTON claimed that the three $100,000 loans were advances on the $1,500,000 loan. FNBM claimed that such loans were separate loans not related to the $1,500,000 loan request and each was secured by distinct collateral. In any event MELTON was convinced at least as of December, 1979 that FNBM was "changing the deal on him."

It was also undisputed at trial that in mid-January, 1980 MELTON received a commitment letter and a draft of the loan agreement and that he showed those documents to his attorney. MELTON had a conversation with Charles Fraser, President of FNBM, during this period of time about the proposed loan. Fraser informed MELTON that he could "take it or leave it." Then on February 29, 1980, FNBM and MELTON, INC. entered into a loan agreement pursuant to which FNBM

was to loan MELTON, INC. $400,000 on a development note and $2,967,000 on a construction note. MELTON testified that, at the time he signed the loan agreement, he believed that Bill Gilluly had lied to him, that there was a conspiracy at FNBM to ruin him and that FNBM was trying to run him out of town. As structured, the loan agreement contemplated the construction of both duplexes at Westgate Acres and the Park.

Testimony at trial established that, as further inducement to FNBM to loan money to MELTON, INC., ALLMAN, ALLMAN, JR., GALLERANO, and DR. MELTON executed $100,000 guaranties. The guaranties reflected on their face that they applied to $100,000 of the debt of MELTON, INC. At trial, the guarantors stated that MELTON told them that their guaranties were limited to a specific $480,000 note executed by MELTON, INC.

It was also undisputed at trial that several loans were made subsequent to the execution of the loan agreement and not pursuant to the loan agreement. Of the total amount of $1,600,755.46 in principal due to FNBM, $1,539,870.46 was not loaned pursuant to the loan agreement.

The testimony at trial established that, in an attempt to obtain a $400,000 loan in July, 1980, MELTON represented to FNBM that Lot 1, Block 7 of Westgate Acres was worth $975,000. Bill Gilluly testified that he refused to accept a $462,000 check and release that parcel of property when MELTON tendered a check in October, 1980 because the sale was to a MELTON owned company and was for less than half the price MELTON had represented it to be worth.

It was also undisputed at trial that the loan agreement required a commitment letter for the construction of a particular duplex before FNBM could advance any funds to MELTON, INC. MELTON claimed that the requirement of a commitment letter was waived. Jananne McLaughlin, an FNBM account officer, testified that in the beginning, FNBM advanced funds prematurely to MELTON, INC. without a commitment letter based on MELTON's representation that a commitment letter would be forthcoming. It was only after sales of duplexes began falling through because there was no

commitment letters that FNBM began insisting on that requirement before it advanced funds.

MELTON, INC. defaulted on its notes, and FNBM posted notice of foreclosure of the property securing the loans. After MELTON, INC. was unable to obtain a temporary retraining order to prevent foreclosure, it filed bankruptcy. At trial, MELTON admitted that bankruptcy was filed to prevent the foreclosure and not because it was truly insolvent.

At trial, plaintiff's damage expert, Jim Roye, admitted that if FNBM was not responsible for MELTON, INC.'s bankruptcy, then FNBM was not responsible for any other damages about which he testified. Roye also testified that none of his damage calculations were valid if the assumptions upon which they were based were invalid. His first assumption was that the Park generated a profit of $184,356 in 1980, $209,202 in 1981 and $474,077 in 1982. The undisputed testimony at trial, however, was that the Park lost $249,000 in 1980 and $148,000 in 1981 and that it made only $7,000 in 1982. Roye also assumed that MELTON, INC. was seeking a $1,500,000 loan at 15% for six years. He admitted that he did not know that MELTON, INC. actually sought to obtain a $1,700,000 loan and that it subsequently had to borrow additional amounts from the bank. The Park when completed cost $2,250,000, and thus the $1,500,000 loan would not have paid for the construction of the Park nor covered the operating deficits. Roye also assumed that MELTON, INC.'s primary source of revenue was land sales. He assumed that all of the land other than the Park could have been sold by June 1982. However, the undisputed testimony at trial established that MELTON was unable to market the duplex property and commercial property because of the rising interest rate and because people were unable to obtain long term financing.

On October 14, 1983, the Office of the Comptroller of the Currency declared FNBM to be insolvent and appointed FDIC as receiver. Simultaneously, a purchase and assumption agreement was executed and a portion of the assets and a continuation of the banking business was sold to Republic Bank First National Midland with FDIC-C taking the remainder of the commercial assets. The loans subject to this

lawsuit were sold to FDIC-C pursuant to the purchase and assumption agreement.

I.

Plaintiffs attempt to void the February 29, 1980 loan agreement and to recover damages based upon the jury findings of breach of the verbal agreement and fraud is barred by the application of *D'Oench Duhme and Company v. Federal Deposit Insurance Corporation*, 315 U.S. 447 (1942). Because *D'Oench Duhme* is equally applicable to protect FDIC-C and FDIC-R, the doctrine can be used to bar both the claims and defenses of the plaintiff.

In *D'Oench Duhme*, the Supreme Court concluded that the FDIC is not bound by verbal agreements between an obligor and a bank insured by the FDIC whereby the obligor is relieved of an obligation evidenced by a written document which is valid on its face. Thus, if a party attempts to defeat the legal effect of an otherwise valid, binding document, then *D'Oench Duhme* applies and the debtor is estopped to assert the existence of such an agreement. *See Federal Deposit Insurance Corporation v. First National Finance Company*, 487 F.2d 1009 (9th Cir. 1978); *Federal Deposit Insurance Corporation v. First Mortgage Investors*, 485 F. Supp. 445 (E.D. Wis. 1980); *Federal Deposit Insurance Corporation v. Powers*, 576 F. Supp. 1167 (N.D. Ill. 1983) and *British Columbia Investment Company v. Federal Deposit Insurance Corporation*, 420 F. Supp. 1217 (S.D. Cal. 1976).

The Supreme Court in *D'Oench Duhme* explained its conclusion as follows:

> Plainly one who gives such a note to a bank with the secret that it will not be enforced must be presumed to know that it will conceal the truth from the vigilant eyes of the bank examiners.
>
> The test is whether the note was designed to deceive the creditors or the public authority or would tend to have that effect.

Id. at 640.

The scope of the *D'Oench Duhme* doctrine depends not on

the obligor's intentional participation in a scheme to defraud but rather on the tendency of the verbal agreement to mislead the bank's creditors, examiners of the FDIC as to the true condition of the bank. The intent of the debtor is irrelevant. Indeed, it is sufficient if the "maker lent himself to a scheme or arrangement whereby the banking authorities on which respondent relied in insuring the bank was or was likely to be misled." *D'Oench Duhme and Company v. Federal Deposit Insurance Corporation, supra.* The "lent himself" standard is satisfied by acts constituting affirmative negligence or acts constituting passive negligence in the form of a failure to take steps to correct a situation which leads to a misrepresentation of the assets on the bank's books. *See Federal Deposit Insurance Corporation v. First National Finance Company, supra* at 1012.

At trial, MELTON testified that Bill Gilluly, the loan officer at FNBM was trying "to sneak something by the auditors." Further, MELTON was of the opinion at the time he signed the loan agreement that FNBM lied to him, that FNBM was engaged in a conspiracy to ruin him and that FNBM was trying to run him out of town. In MELTON's opinion, the enforceable agreement was the verbal agreement to loan $1,500,000. MELTON, INC. thus "lent itself" to a transaction which had the tendency to mislead the shareholders and creditors of FNBM. The bank examiners, creditors and shareholders of FNBM were entitled to rely upon the documents contained in the file in evaluating the assets and liabilities of FNBM. Because the executed written documents which evidenced the agreement between the parties contained no reference to and did not set forth the verbal agreement, the transaction had a tendency to mislead and MELTON, INC. is estopped to assert such an agreement either in support of its claim to void the loan agreement or to recover damages.

By the same rationale, the claim of the guarantors that their guaranties were limited to a $480,000 note must fail as a matter of law. Once again, the fact was not reflected in the guaranties. Such a claim falls clearly within the rationale of the *D'Oench Duhme* doctrine because the guarantors are

claiming that they entered into a transaction with FNBM where by the true nature of the transaction was not accurately reflected in the documents executed between the parties and the documents on which the shareholders, creditors and bank examiners were entitled to rely.

The fact that the pending litigation was on file at the time of the failure of FNBM is of no consequence because *D'Oench Duhme* was designed to protect creditors and shareholders, and thus it applies even if both the creditors and FDIC were not actually deceived by the fraud. *British Columbia Investment Company v. Federal Deposit Insurance Corporation, supra* at 1244.

To allow MELTON, INC. to succeed on its claim against FDIC-R and FDIC-C would be to deny the appropriate protection afforded the innocent parties caught in the failure of FNBM. Therefore, because the written loan agreement executed by the parties makes no reference to the verbal agreement, the application of *D'Oench Duhme* prevents plaintiff's attempt to collect damages based on the jury findings of breach of verbal agreements and fraud and to avoid the loan agreement.

II.

FDIC-C filed a counterclaim against plaintiff to collect $1,600,755.46 in principal plus accrued interest still owing from the notes executed by MELTON, INC. and to foreclose on the property securing those notes. In an attempt to avoid payment, plaintiff claimed that the November verbal agreement voided the February loan agreement and raised the defenses of breach of the verbal agreement and fraud in the inducement. The application of 12 U.S.C. Section 1823(e) defeats plaintiff's attempts to raise these defenses to void the obligation and the collateral held by FDIC-C.

The *D'Oench Duhme* doctrine was expanded and codified in Section 1823(e) to provide additional protection to FDIC-C. The protection afforded by Section 1823 (e) is available only to FDIC-C in a purchase and assumption transaction. 12 U.S.C. Section 1823(e) provides in pertinent part:

> No agreement which tends to diminish or defeat the right, title or interest of the corporation in any asset acquired by it under this section, either as security for a loan or by purchase, shall be valid against the corporation unless such agreement (1) shall be in writing, (2) shall have been executed by the bank and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the bank, (3) shall have been approved by the board of directors of the bank or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) shall have been, continuously, from the time this execution, an official record of the bank.

The purpose of Section 1823(e) has been summarized as follows:

> It is clear that the quoted section operates to insure that the FDIC, when it expends monies entrusted to it to purchase assets of a closed insured bank, can rely on the bank's records and will not be risking an impairment of the assets through an agreement not contained in the bank's records.

Federal Deposit Insurance Corporation v. Vogel, 437 F. Supp. 660, 663 (E.D. Wis. 1977). Section 1823(e) applies when the FDIC acts in its corporate capacity, as opposed to its capacity as a receiver for a closed, insured bank, e.g., *Federal Deposit Insurance Corporation v. Godshall*, 558 F.2d 220 (4th Cir. 1977), and it affords protection greater than that accorded a holder in due course under the Uniform Commercial Code. E.g., *Federal Deposit Insurance Corporation v. Kucera Builders, Inc.*, 502 F. Supp. 967, 971 (N.D. Ga. 1980). In the instant case, section 1823(e) is applicable because FDIC-C acquired the MELTON, INC. notes and deeds of trust as part of the FNBM purchase and assumption transaction.

Plaintiff alleged that because the November, 1979 verbal agreement was breached, the loan agreement is void and

FDIC-C cannot collect on its notes. It also alleged the existence of a verbal agreement to the loan agreement: that the loan would be refinanced and that commitment letters would not be required of purchasers of the duplexes. These defenses must fail as a result of the application of Section 1823(e). These alleged verbal agreements were not in writing, not signed by FNBM, not approved by FNBM's board of directors and were not official records of FNBM. *See Black v. Federal Deposit Insurance Corporation*, 640 F.2d 699 (5th Cir.) *cert. denied* 454 U.S. 838 (1981); *Chatham Ventures, Inc. v. Federal Deposit Insurance Corporation*, 651 F.2d 355 (5th Cir. 1981); and *Federal Deposit Insurance Corporation v. Hoover Morris Enterprises*, 642 F.2d 785 (5th Cir. 1981).

Section 1823(e) also operates to defeat MELTON's defense of fraud in the inducement. The courts have distinguished between two types of fraud in the inducement in determining when Section 1823(e) is applicable. One type of fraud in the inducement is a representation made by a bank, not involving a promise, which induces a party to execute a promissory note. *See*, e.g., *Gunter v. Hutcheson*, 674 F.2d 862, 867 (11th Cir. 1982), *cert. denied*, 459 U.S. 826 (1982). Section 1823(e) is inapplicable to this type of fraud because there is no secret side agreement between the parties. However, FDIC-C may still rely on federal common law defense which protects it from fraud claims of which it lacks knowledge.

Section 1823(e) does apply to the type of fraud in the inducement which involves an oral promise by a bank to perform a duty in connection with the execution of a note that the bank does not intend to perform. Section 1823(e) applies to this type of fraud in the inducement because there is a secret side agreement present. Even though the secret side agreement may have been the fraudulent inducement to the debtor, it is still a separate agreement into which the parties voluntarily entered. That such agreements might be fraudulently induced is immaterial; the important question is whether the parties voluntarily entered into such a side agreement. Because the agreement was voluntarily entered into, the real issue is one of breach and not of fraud, and a breach claim is not enforceable against FDIC-C. Courts have

refused to allow a plaintiff to make an "end-run" around Section 1823(e) by allowing him to "avoid the effect of Section 1823(e) by addressing his breach of the oral agreement up in the garb of fraud in the inducement." *See Federal Deposit Insurance Corporation v. Lattimore Land Corporation*, 656 F.2d 139, 146 n.13 (5th Cir. 1981), and *Federal Deposit Insurance Corporation v. Hatmaker*, Slip Op. No. 83-5866 (6th Cir. March 1, 1985).

MELTON, INC.'s claim of fraud falls squarely within the second fraud category, since the claim involves FNBM's alleged agreement to make a $1,500,000 loan at 15% for six years. There was no dispute that this agreement was voluntarily entered into. The real issue is breach, because Section 1823 (e) prevents MELTON, INC. from making an "end run" around the statute by couching his claim in terms of fraud. Obviously, Section 1823(e) defeats the breach of verbal agreement claim. Additionally, the court notes that the sole testimony concerning damages under the verbal agreement was a breach measure and not a fraud measure.

The failure of FNBM's records to indicate in the manner provided in Section 1823(e) an agreement that substantially vitiates the apparent rights of FNBM under the MELTON, INC. notes and deed of trust would tend to mislead the FDIC. It is therefore, unnecessary to establish that MELTON, INC. acted to deceive the FDIC when making the verbal side agreement. *See*, e.g., *Chatham Ventures, Inc. v. Federal Deposit Insurance Corporation, supra* at 361-62, and *Federal Deposit Insurance Corporation v. Hatmaker, supra.*

The mere fact that the deeds of trust were in litigation at the time FDIC acquired them and the notes they covered has no impact upon the protection afforded by Section 1823(e). *Federal Deposit Insurance Corporation v. First Mortgage Investors, supra. See also Federal Deposit Insurance Corporation v. Merchants' National Bank*, 725 F.2d 634, 640 (11th Cir. 1984) and *Federal Deposit Insurance Corporation v. de Jesus Velez*, 678 F 2d 371, 375 (1st Cir. 1982).

Accordingly, FDIC-C is entitled to recover from MELTON, INC. and from MELTON and LYNN BRYANT (both of whom executed unlimited guaranties for the MELTON, INC. debt)

the total amount due on the notes. FDIC-C is also entitled to collect $100,000 from each of the other limited guarantors.

III.

The jury finding of economic duress must fail as a matter of law because MELTON, INC. failed to establish the elements of economic duress. To prevail on its claim of economic duress, MELTON, INC. is required to establish the following essential elements:

1. FNBM made a threat to MELTON, INC. to do some act which it had no legal right to do;

2. The threat must have been of such a character as to destroy the free agency of MELTON, INC. It must have overcome its will and caused it to do that which it would not otherwise have done, and which it was not legally bound to do;

3. The restraint caused by such threat must have been imminent;

4. The threat must have been such that MELTON, INC. had no present means of protection.

First Texas Savings Association of Dallas v. Dicker Center, Inc., 631 S.W.2d 179, 185 (Tex. App.-Tyler 1982, no writ); *Sonnleitner v. Commissioner of Internal Revenue*, 598 F.2d 464, 468 (5th Cir. 1979).

At trial, MELTON testified that in January of 1980, Charles Fraser told him that, with reference to FNBM's proposed loan to MELTON, INC. he could "take it or leave it." The Court cannot find that this was such a threat to fit the legal definition of economic duress. FNBM had the legal right to require MELTON, INC. to agree to its term or not to make the loan.

Further, there was no evidence at trial that MELTON, INC. was restrained by an imminent threat. The testimony established that MELTON had more than one month to review the loan agreement and actually showed a draft of the loan agreement to his attorney. MELTON had a means of

protection for he certainly could have initiated a lawsuit against FNBM if he in fact believed that he was being lied to and was being forced to execute the loan agreement. *Tower Contracting Company, Inc. of Texas v. Burden Brothers, Inc.*, 482 S.W.2d 330 (Tex. Civ. App.-Dallas 1972, write ref'd n.r.e.). Because plaintiff failed to establish the essential elements of economic duress, its claim must fail.

IV.

Plaintiff's claims for breaches of the loan agreement must also fail as a matter of law since plaintiff failed to establish that the loan agreement was breached. Although plaintiff claimed that FNBM breached the loan agreement by failing to timely disburse funds, the only testimony at trial concerning this point came from Jananne McLaughlin, the account officer at FNBM with whom MELTON dealt. Her undisputed testimony was that, in fact, funds were advanced prematurely to MELTON, INC. The loan agreement required a commitment letter before funds could be advanced but based on MELTON'S representation that commitment letters were forthcoming, FNBM advanced funds prematurely. There was no evidence at trial that any funds were not timely advanced.

The failure of FNBM to accept a $462,000 check for release of Lot 1, Block 7, Westgate Acres, does not constitute breach of the loan agreement. MELTON testified at trial that in July, 1980, he represented to FNBM that that particular parcel of property was worth $975,000; such representation was made only to induce FNBM to advance MELTON, INC. more funds. Because MELTON tried to sell the property to a company owned by him and the check was for an amount less than the value that he represented the property to be worth, the attempted sale was not an arm's length transaction and contradicted MELTON's representations about the value of the property. This being the case, the refusal of FNBM to release the property does not amount to breach of the loan agreement.

The only testimony at trial concerning any damages which might have resulted from the failure of FNBM to accept the

$462,000 came from Jananne McLaughlin. Plaintiff's attorney had her calculate the interest which could have been saved had the check been accepted and applied to the loan, assuming that the interest rate at the time was 15%. The evidence was that the interest rate was not 15%, but rather that interest rates were volatile at that time and that MELTON, INC.'s interest rate floated at 1% over First National Bank of Dallas prime. Mrs. McLaughlin calculated that, if the interest rate was fixed at 15%, the interest saved would be $730,000. There was simply no evidence to support the jury's finding of damages in the amount of $1,482,000. Because there was no proof of the actual interest rate from the date the check was tendered until the present and because there was no evidence to support a jury finding of $1,482,000, the jury finding of damages as to breach of the loan agreement must fail as a matter of law.

The Court also notes that the loan agreement does not provide for a specific release price for the property. At best, the loan agreement provides for how the funds from a sale or refinancing of that particular property are to be applied. The loan agreement provides that "upon application of the proceeds," FNBM would execute an appropriate release of the property. Nowhere in the loan agreement pertaining to the sale or refinancing of Lot 1, Block 7 of Westgate Acres does the loan agreement state that upon tender of a certain amount of money, FNBM must release the property. If that had been the intention of FNBM, the language would have been phrased like that found with reference to specific unimproved duplex lots. Under that provision, the language specifically states that FNBM will release property upon receipt of a per lot release sum of $7,500.

V.

Plaintiff has failed to establish the requisite elements to show that MELTON was fraudulently induced to sign his personal guaranty, and therefore the jury finding of fraudulent inducement with reference to the MELTON guaranty must fail.

To sustain a cause of action based on fraud, MELTON must

establish the following elements:

1. a material representation was made;
2. it was false;
3. when the representation was made, the speaker knew it was false or made it recklessly without any knowledge as to the truth and as a positive assertion;
4. the speaker made the representation with the intent that it should be acted upon;
5. the party acted in reliance upon the representation, the party suffered injury.

Stone v. Lawyer's Title Insurance Corporation, 554 S.W.2d 183, 185 (Tex. 1977). As early as January 21, 1980, MELTON had received a copy of the commitment letter and a draft of the loan agreement from FNBM. MELTON was obviously aware no later than that date what the terms of the loan FNBM was willing to make, and there was absolutely no evidence at trial that anything was misrepresented to him at that time or that he acted in reliance upon any such misrepresentation. Based upon MELTON's unlimited guaranty, then FDIC-C is entitled to collect the entire amount due on the notes from him.

VI.

Plaintiff entered into the February 29, 1980 loan agreement and accepted the benefits thereunder. He is, therefore, estopped to deny the existence of a valid contract. At trial, MELTON admitted that by the time he entered into the February 29, 1980 loan agreement, he believed that Bill Gilully had lied to him, that there was a conspiracy at FNBM to ruin him, and that FNBM was trying to run him out of town. By virtue of this purported knowledge prior to the time he entered into the loan agreement, he is estopped at this juncture to deny the existence of a valid loan agreement. Further, by accepting benefits under the loan agreement, MELTON, INC. ratified any actions of FNBM which it may now complain. MELTON, INC. also renewed several of the loans

made to it, thus deeming to have freed the transaction from any alleged fraud.

VII.

Notwithstanding the foregoing, the Court is convinced that even if plaintiff had made out each cause of action, recovery must still be denied because of the failure to establish causation and damages. MELTON testified at trial that after FNBM had posted notice of foreclosure, MELTON, INC. filed a suit in state court and attempted to obtain a temporary restraining order to prevent FNBM from foreclosing upon Westgate Acres. After failing in obtaining a TRO, MELTON, INC. filed bankruptcy in order to prevent the sale of the property. In short, all of MELTON, INC.'s testimony concerning damages relates to values that were lost as a result of being in Chapter 11. Plaintiff's damages expert, Jim Roye, admitted that if FNBM was not responsible for MELTON, INC.'s bankruptcy, then it was not responsible for any of the damages about which he testified. There thus was no testimony that plaintiff suffered any damages as a result of the alleged fraud, breach of verbal agreement, economic duress or breach of contract.

Plaintiff's damages expert testified that none of his damage calculations were valid if the assumptions upon which they were based were invalid. Because the expert admitted that at least one-half of his assumptions were invalid, the jury verdict based on his conclusions must fail.

VIII.

It is the firm opinion of this Court that plaintiff's favorable jury verdict must fail as a matter of law. Judgment shall be rendered in favor of the Federal Deposit Insurance Corporation, notwithstanding the verdict, in accordance with the memorandum opinion.

SIGNED and ENTERED this the 19th day of April, 1985.

/s/

LUCIUS D. BUNTON
United States District Judge

APPENDIX D

**IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
MIDLAND/ODESSA DIVISION**

T. J. MELTON, III and ASSOCIATES, INC., *Plaintiff*	)	
v.	)	
FEDERAL DEPOSIT INSURANCE CORPORATION, in its capacity as receiver of FIRST NATIONAL BANK OF MIDLAND and ALAN A. AARON, Substitute Trustee, *Defendants*	)	
and	)	NO. MO-84-CA-22
FEDERAL DEPOSIT INSURANCE CORPORATION, in its Corporate Capacity, *Third-Party Plaintiff*	)	
v.	)	
T. J. MELTON, III and ASSOCIATES, INC., T. JUNE MELTON, III, JOHN C. ALLMAN, JR., LYNN W. BRYANT, T. JUNE MELTON, M.D., and A. J. GALLERANO, *Third-Party Defendants*	)	

VERDICT FORM

Answer all the following questions from a preponderance of the evidence.

1. (a) Do you find that FIRST NATIONAL BANK OF MIDLAND entered into a verbal agreement with MELTON, INC. in November, 1979 to loan it 1.5 million dollars payable in six years at an interest rate of 15% and that the FIRST NATIONAL BANK OF MIDLAND breached this agreement?

Answer "Yes" or "No."

ANSWER: Yes.

If you have answered "yes" to Question 1(a), then answer Question 1(b); otherwise disregard Question 1(b).

(b) What sum of money, if any, do you find would reasonably compensate MELTON, INC. for the damages incurred as a result of said breach?

Answer in dollars and cents or "none."

ANSWER: $3,091,500.00

2. (a) Do you find that FIRST NATIONAL BANK OF MIDLAND represented to MELTON, INC. in November of 1979 that it would lend 1.5 million dollars payable in six years at an interest rate of 15%?

Answer "Yes" or "No."

ANSWER: Yes.

If you have answered "yes" to Question 2(a), then answer Question 2(b); otherwise disregard Question 2(b).

(b) Do you find that such representations were fraudulent?

Answer "Yes" or "No."

ANSWER: Yes.

If you have answered "yes" to Question 2(b), then answer Question 2(c); otherwise disregard Question 2(c).

(c) What sum of money, if any, do you find would reasonably compensate MELTON, INC. for the damages incurred as a result of such fraudulent representations?

Answer in dollars and cents, or none.

ANSWER: $730,000.00

3. (a) Do you find that MELTON, INC. entered into the February 29, 1980 loan agreement with FIRST NATIONAL BANK OF MIDLAND as a result of economic duress imposed by FIRST NATIONAL BANK OF MIDLAND?

Answer "Yes" or "No."

ANSWER: Yes.

If you have answered "yes" to question 3(a), then answer question 3(b); Otherwise, disregard question 3(b).

(b) What sum of money, if any, do you find would reasonably compensate MELTON, INC. for damages incurred as a result of said economic duress?

Answer in dollars and cents, or none.

ANSWER: $5,121,000.00

4. (a) Do you find that FIRST NATIONAL BANK OF MIDLAND breached the February 29, 1980 loan agreement?

Answer "Yes" or "No."

ANSWER: Yes.

If you have answered "yes" to Question 4(a), then answer Question 4(b); otherwise disregard Question 4(b).

(b) What sum of money do you find would reasonably compensate MELTON, INC. for damages incurred as a result

Answer in dollars and cents, or none.

ANSWER: $1,482,000.00

5. Do you find that FIRST NATIONAL BANK fraudulently induced T. JUNE MELTON, III into signing the individual personal guaranty of the loan of MELTON, INC.?

Answer "Yes" or "No."

ANSWER: Yes.

6. Do you find that the personal guaranties of JOHN ALLMAN, JOHN ALLMAN, JR., A. J. GALLERANO and DR. T. JUNE MELTON were limited to a note in the principal amount of $480,000.00, described as the "equity note."

Answer "Yes" or "No."

ANSWER: Yes.

/s/

JOHN T. GRAY
FOREPERSON

DATE: March 22, 1985

No. 86-1741 (2)

In the Supreme Court of the United States

OCTOBER TERM, 1986

T. J. MELTON, III AND ASSOCIATES, INC.,
ET AL., PETITIONERS

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

*ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

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15 pp

QUESTION PRESENTED

Whether the court of appeals correctly rejected petitioners' attempt to defeat their loan obligations to the Federal Deposit Insurance Corporation (FDIC) under notes acquired by the FDIC from a failed bank.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A5) is unreported. The opinion of the district court (Pet. App. C1-C16) is also unreported.

JURISDICTION

The judgment of the court of appeals was entered on December 29, 1986. The petition for a writ of certiorari was filed on March 28, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. This case arises from the failure of the First National Bank of Midland, Texas (FNB), on October 14, 1983. The same day, the Federal Deposit Insurance Corporation (FDIC) was appointed to be the receiver for the bank, and the FDIC arranged a purchase and assumption of FNB's assets. As part of that transaction, the FDIC, in its distinct corporate capacity, acquired a portion of those

assets, including two notes totalling more than $3.3 million executed in early 1980 by T. J. Melton, III and Associates, Inc. (Melton, Inc.), and guaranteed by, among others, T. June Melton, III, the petitioners here. Pet. 2; Pet. App. C3-C6.

For several months prior to the execution of the notes and guarantees, petitioners had negotiated with FNB to obtain funds to develop a water-theme amusement park (Pet. App. C2-C3). According to petitioners, FNB had agreed orally in November 1979 to their initial request for a $1,500,000 loan at 15% for six years, though the bank had requested additional information. Petitioners later increased their request to $1,700,000, but FNB, after receiving the requested information, indicated that it was not interested in lending money for a venture as speculative as an amusement park. In February 1980, FNB and petitioners agreed to loans, and signed notes, in the amount of $3,367,000 for a project that included the park and commercial and residential development. Pet. App. C3-C4.

Petitioners defaulted on their obligations under the notes in 1982. When FNB initiated foreclosure proceedings, petitioner Melton, Inc., immediately brought suit against the bank in Texas state court, alleging, among other things, that the bank breached the alleged November 1979 agreement, that the November 1979 agreement constituted fraudulent inducement for the February 1980 agreement, and that the February 1980 notes were executed under economic duress placed on petitioners by the bank's breach of the alleged November 1979 agreement to lend petitioners $1.5 million (Pet. 3-4; Pet. App. C5).[1] FNB failed in 1983, and the FDIC acquired the notes in its corporate capacity. The FDIC in its receivership capacity

[1] After the Texas court denied its motion for a temporary restraining order against the foreclosure, petitioner Melton, Inc., filed for bankruptcy, admittedly not because it was insolvent, but only to forestall the foreclosure (Pet. App. C5).

was substituted for the bank in petitioners' state-court action; the case was removed to the United States District Court for the Western District of Texas; and the FDIC in its corporate capacity filed a third-party complaint against petitioners and the other guarantors for the balance owing on the notes. Pet. 3.

2. The case was tried to a jury, which found in favor of petitioners and the other guarantors. The district court, however, found the jury verdict unsupported by the evidence and contrary to law on numerous grounds (Pet. App. C1-C16). The court therefore entered judgment for the FDIC notwithstanding the verdict (Pet. App. B1-B2).

The court first held that *D'Oench, Duhme & Co.* v. *FDIC*, 315 U.S. 447 (1942), barred petitioners' claims of fraud and breach of contract (Pet. App. C6-C8). By allegedly entering into an oral agreement, petitioners lent themselves to a transaction that was nowhere reflected in the bank's books and that, therefore, would tend to mislead bank examiners (*ibid.*). Under *D'Oench, Duhme & Co.*, the court held, petitioners were accordingly barred from raising the oral agreement against either the FDIC as receiver or the FDIC in its corporate capacity, even if the FDIC knew of the pending litigation when the bank failed (Pet. App. C8).

The court next held that 12 U.S.C. 1823(e) barred two defenses raised by petitioners and the other guarantors to the third-party claim made by the FDIC in its corporate capacity for the balance on the note (Pet. App. C8-C12). The first defense—that FNB breached various oral agreements, including the alleged November 1979 agreement—was plainly barred because the agreements met none of the requirements specified in the statute (*id.* at C9-C10). The second defense—fraud in the inducement—was likewise barred because it rested squarely on the claim that there was a secret side agreement (the bank's alleged

November 1979 oral agreement to lend petitioners $1.5 million) (*id.* at C10-C11).[2] The court also observed that the FDIC's knowledge of the claims against the bank at the time it acquired the notes did not affect the FDIC's entitlement to protection against such claims under Section 1823(e) (Pet. App. C11).

Having addressed the federal-law issues, the district court considered the state-law issues. The court set aside the jury finding of economic duress, ruling that, under Texas law, petitioners had failed to make out the defense (Pet. App. C12-C13). The court held that the bank's presentation of "take it or leave it" loan terms did not constitute economic duress for three reasons—the bank had a legal right to make the offer; petitioners, who took more than one month to review the offer and consulted an attorney, were not under imminent threat; and petitioners had ample opportunity to protect themselves by filing a lawsuit (*ibid.*). In addition, the court rejected as unsupported by the evidence the contentions that the bank breached the February 1980 loan agreement (*id.* at C13-C14) and that the guarantee signed by petitioner Melton was fraudulently induced (*id.* at C14-C15). The court further held that petitioners were estopped from denying the validity of the February 1980 loan agreement and that petitioner Melton, Inc., had ratified the actions of the bank by signing and later renewing various loan agreements (*id.* at C15-C16). Finally, the court held that relief to petitioners must be denied on the additional and

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[2] The court pointed out that *Gunter v. Hutcheson,* 674 F.2d 862, 867 (11th Cir.), cert. denied, 459 U.S. 826 (1982), had stated that 12 U.S.C. 1823(e) does not bar a claim of fraud in the inducement based on fraudulent factual representations, as opposed to fraudulent promises. The district court noted that this case involves promissory fraud and therefore, even under *Gunter*'s analysis, is subject to Section 1823(e). Pet. App. C10.

independent ground that there was "no testimony that plaintiff suffered any damages as a result of the alleged fraud, breach of verbal agreement, economic duress or breach of contract" (*id.* at C16).

3. The court of appeals, in an unpublished opinion, "affirmed in all respects except for the denial of attorney fees to the FDIC in its corporate capacity" (Pet. App. A2). The court first held that petitioners' (and the other guarantors') defenses against the FDIC in its corporate capacity, which were based on oral agreements not recorded in the books or records of the insured bank, were barred by 12 U.S.C. 1823(e), irrespective of any knowledge of the defenses the FDIC may have had upon acquiring the notes (Pet. App. A2). The court also rejected petitioners' claims against the FDIC as receiver: the court held that petitioners wholly "failed to prove reasonably certain damages caused by any failed promise or wrong of FNB" (*id.* at A3). See *ibid.* (even assuming some economic duress, petitioners did not prove damages from the duress; "certainly there is no proof of [petitioners'] damages caused by culpability of the bank"); *id.* at A4 (petitioner Melton, Inc., "may have suffered damages because [it] did not get the $1.5 million loan, but [it] has made no attempt to prove what they were"). Finally, the court of appeals held that petitioners failed to show any breach by the bank of the February 1980 agreement (*id.* at A4-A5) and that the district court had erred in denying the FDIC attorney's fees (*id.* at A5).

ARGUMENT

Although petitioners raised many claims and defenses in the courts below, they[3] present only one question in this Court—whether 12 U.S.C. 1823(e) bars their defense of

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[3] Aside from petitioner Melton, the guarantors on the note have not petitioned for review of the court of appeals' decision.

economic duress to the note held by the FDIC in its corporate capacity. Petitioners' request for this Court's review on that question is patently without merit.

1. The question presented by petitioners was not ruled on by the lower courts or raised by petitioners in the court of appeals. Neither the court of appeals nor the district court held or stated that, or even considered whether, Section 1823(e) bars the defense of economic duress. The district court rejected the economic duress defense without reaching the question whether the defense was barred by Section 1823(e). Accordingly, the court of appeals had no occasion to address the question, and it did not do so. Likewise, petitioners had no occasion to raise the question in the court of appeals, and they did not do so. Rather, the district court and the court of appeals ruled only that Section 1823(e) barred petitioners' breach-of-contract and fraud defenses, rulings that petitioners do not challenge here. Pet. App. A2, C8-C12; 85-1331 & 86-1285 Appellants' Br. In sum, there is no lower-court ruling on petitioners' contention for this Court to review, and the question presented is not in the case.

2. The district court found that petitioners had wholly failed to prove economic duress (Pet. App. C12-C13). Although petitioners challenged that finding on appeal, the court of appeals affirmed the district court's judgment "in all respects" (Pet. App. A2). Not surprisingly, petitioners do not ask this Court to review the finding that they failed, under standards defined by Texas law, to make out the defense (see Pet. i (Questions Presented); Pet. 11-14).[4] Thus, petitioners' economic duress defense

[4] Petitioners do not contest the district court's view of the requirements of economic duress under Texas law (Pet. 11-13; Pet. App. C12; 85-1331 Appellants' Br. 20 ("Melton, Inc. takes no issue with the trial court's analysis of the legal requirement to establish economic duress.")). The rejection of the defense, for the reasons given by the district court (Pet. App. C12-C13), is obviously correct.

has already been fully considered and finally rejected. Any ruling by this Court on petitioners' contention that 12 U.S.C. 1823(e) permits them to prove economic duress could have no effect on the judgment in this case.

3. Even if petitioners' contention concerning 12 U.S.C. 1823(e) were properly before this Court, review still would not be warranted. Not even petitioners contend that there is a conflict among the lower courts on whether Section 1823(e) bars a defense of economic duress. Moreover, a ruling against petitioners on that question, if one existed, would be correct.

As petitioners concede (Pet. 9), their economic duress defense was premised on the alleged November 1979 oral agreement by the bank to lend them $1.5 million, an agreement petitioners allegedly relied on and the bank allegedly broke. Section 1823(e), which by its terms declares any such oral agreement not to be "valid against the [FDIC]," was designed to protect the FDIC and its insurance fund (and hence depositors nationwide) against any agreements that are not reflected, in a carefully prescribed manner, in the books and records of the insured institution. The provision enables the FDIC to rely on bank records both in examining insured banks for soundness and in determining with necessary expedition how to deal with a failed bank.[5] The alleged undisclosed November 1979 loan

[5] When a bank is closed by its chartering authority, the FDIC must determine whether to liquidate the bank and pay the insured statutory amounts from the Permanent Insurance Fund (12 U.S.C. 1821(f)) or to take the less drastic step of arranging a purchase and assumption transaction (12 U.S.C. 1823(c)(2)(A)), which ordinarily results in a reopening of the failed bank the next business day and the full protection of all depositors of the bank (see *Gunter* v. *Hutcheson*, 674 F.2d 862, 865-866 (11th Cir.), cert. denied, 459 U.S. 826 (1982)). Which course to take must be decided "with great speed, usually overnight" (674 F.2d at 865). By statute, the FDIC generally may choose the preferred purchase-and-assumption option only if the costs to the Permanent Insurance Fund are less than they would be in a straight

promise by the bank, which petitioners could readily have insisted be placed in writing in accordance with the terms of Section 1823(e), is precisely the sort of agreement the statute permits the FDIC to ignore. See *Black* v. *FDIC*, 640 F.2d 699 (5th Cir.), cert. denied, 454 U.S. 838 (1981); *FDIC* v. *Hatmaker*, 756 F.2d 34 (6th Cir. 1985); *FDIC* v. *Lattimore Land Corp.*, 656 F.2d 139 (5th Cir. 1981); *FDIC* v. *Rodenberg*, 571 F. Supp. 455 (D. Md. 1983); *FDIC* v. *Kucera Builders, Inc.*, 503 F. Supp. 967 (N.D. Ga. 1980).[6] If some loss results from such an agreement, Section 1823(e) requires that it be borne not by the FDIC fund but by the parties who were in a position to have protected themselves.[7]

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insurance payoff (12 U.S.C. 1823(c)(4)(A)). Because of the speed with which that cost determination must be made, the ability to rely on bank records, and to avoid inquiries into court documents, state law, and other matters outside bank records, is critical to the FDIC's performance of its functions.

Here, the closure of the bank and the consummation of the purchase-and-assumption transaction both took place on October 14, 1983 (Pet. App. C5).

[6] See also *FDIC* v. *O'Neil*, 809 F.2d 350 (7th Cir. 1987) (Section 1823(e) bars debtor's claim that an unexecuted side agreement referred to in his note could be used as a defense against the FDIC); *Public Loan Co.* v. *FDIC*, 803 F.2d 82 (3d Cir. 1986) (Section 1823(e) bars claim of accord and satisfaction); *FDIC* v. *Fonseca*, 795 F.2d 1102 (1st Cir. 1986) (Section 1823(e) bars defense that debtor never received consideration for the loan); *FDIC* v. *Castle*, 781 F.2d 1101 (5th Cir. 1986) (Section 1823(e) bars partners' claim that they were to be collectively liable for only a portion of the debt); *FDIC* v. *Merchants Nat'l Bank*, 725 F.2d 634 (11th Cir.), cert. denied, 469 U.S. 829 (1984) (Section 1823(e) bars claim that loan participation did not fully reflect the agreement between the banks); *Chatham Ventures, Inc.* v. *FDIC*, 651 F.2d 355 (5th Cir. 1981), cert. denied, 456 U.S. 972 (1982) (Section 1823(e) bars assertion that bank breached a joint venture agreement); *FDIC* v. *Hoover-Morris Enterprises*, 642 F.2d 785 (5th Cir. 1981) (Section 1823(e) bars claim that bank agreed not to seek a deficiency judgment).

[7] Here, of course, a "loss" is not at issue in the dispute between petitioners and the FDIC in its corporate capacity. All that is at issue is the

Use of an oral agreement to invalidate written obligations—here, petitioners' attempt to invalidate the written notes on the ground of economic duress caused by the bank's failure to live up to its alleged November 1979 agreement—would just as surely defeat the statutory protection of the FDIC as direct assertion of the validity of the oral agreement. The lower courts uniformly recognize this point.[8] Petitioners seek support for the contrary suggestion (Pet. 5-11) in two decisions concerning a fraud-in-the-inducement defense to a note (*Gunter* v. *Hutcheson*, 674 F.2d 862 (11th Cir.), cert. denied, 459 U.S. 826 (1982); *FDIC* v. *Hatmaker, supra*). Those decisions, however, merely suggest that where a claim of fraud is premised on *factual* misrepresentations, Section 1823(e) is inapplicable because no "agreement" is involved. As even petitioners acknowledge (Pet. 8), the cited decisions recognize that, if a *promise* is the basis of the fraud allegation, then an "agreement" is involved, and Section 1823(e) bars a fraud-in-the-inducement defense just as it bars assertion of the promise as itself a valid agreement (*Gunter*, 674 F.2d at 867; *Hatmaker*, 756 F.2d at 36-37).[9] The alleged agree-

FDIC's attempt to recover from petitioners funds they received from the bank under the February 1980 loan agreement.

[8] See *FDIC* v. *Armstrong*, 784 F.2d 741 (6th Cir. 1986); *FDIC* v. *Castle*, 781 F.2d 1101 (5th Cir. 1986); *FDIC* v. *W.H. Venture*, No. 84-5673 (E.D. Pa. May 22, 1986); *FDIC* v. *Vestring*, 620 F. Supp. 1271 (D. Kan. 1985). See also *FDIC* v. *O'Neil*, 809 F.2d 350, 354 (7th Cir. 1987); *FDIC* v. *Lattimore Land Corp.*, 656 F.2d at 146 n.13 (fraudulent inducement defense would permit "an end run around § 1823(e)"); *FDIC* v. *Rodenberg*, 571 F. Supp. 455, 459 (D. Md. 1983) ("To permit the defendant to raise these representations in a defense of fraudulent or negligent misrepresentations—while barring their admission as collateral agreements—would allow the defendant to make an 'end run' around § 1823(e).").

[9] Petitioners also cite *FDIC* v. *Balistreri*, 470 F. Supp. 752 (E.D. Wis. 1979), for the proposition that "[t]he affirmative defense of economic duress is closely akin to that of fraud in the inducement"

ment underlying petitioners' defense is a promise to lend money, not a factual misrepresentation (Pet. App. C10-C11). Thus, the decisions on which petitioners rely plainly support rejection of petitioners' defense.

Similarly, the courts of appeals have uniformly rejected the argument made by petitioners (Pet. 14-18) that 12 U.S.C. 1823(e) should not apply where the FDIC has knowledge of a debtor's defense. *FDIC* v. *O'Neil, supra; FDIC* v. *Merchants Nat'l Bank,* 725 F.2d at 640; *FDIC* v. *de Jesus Velez,* 678 F.2d 371, 375 (1st Cir. 1982). The *Gunter* decision, as the excerpt quoted by petitioners shows (Pet. 14), is not to the contrary: the court there stated that the FDIC's knowledge of defenses was relevant, not under Section 1823(e), but under federal common law.[10] The courts' unanimity on this issue is hardly surprising, since there is no suggestion of a knowledge exception in the language of Section 1823(e). The statute, indeed, is explicit in its requirements that an enforceable agreement be written "contemporaneouly" with the creation of the asset involved and be reflected "continuously" on the bank's records from its inception, requirements plainly designed to enable bank regulators to be aware *at all times* of any agreement that would diminish the value of a bank asset. Accordingly, the protection of the statute does not disappear if, for example, the FDIC happens to learn of an off-the-books agreement during the few hours when it is determining how to deal with a failed bank.

4. For all of the above reasons, review by this Court of the decision of the court of appeals would be inappropriate. Nor should the petition be held pending this

(Pet. 6). *Balistreri* held, however, that Section 1823(e) protects the FDIC in its corporate capacity against fraud-in-the-inducement defenses (470 F. Supp. at 756-757).

[10] Moreover, *Gunter* found the FDIC protected under federal common law (674 F.2d at 868-874). Accord, *FDIC* v. *Armstrong,* 784 F.2d 741 (6th Cir. 1986).

Court's decision in *Langley* v. *FDIC,* cert. granted, No. 86-489 (Jan. 12, 1987), in which debtors contend that 12 U.S.C. 1823(e) does not bar defenses of fraudulent inducement based on a bank's false factual representations. The *Langley* case focuses on the distinction between promissory and factual fraud, as to which there is some disagreement among the courts of appeals. The instant petition, as we have explained, does not properly present any issue concerning Section 1823(e) for decision. Moreover, the basis for petitioners' defense here is a promise, not a factual misrepresentation; and there is no conflict over Section 1823(e)'s application to such a defense.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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